

Private Letter Ruling: Compensation paid to nonresident movie director/producer for period during which filming takes place in Illinois is not paid in Illinois because services are provided outside Illinois which are not incidental to services provided in Illinois, and neither the base of operations nor place of direction or control is within Illinois.

June 1, 1999

Dear:

This is in response to your letter dated May 28, 1999, in which you request a Private Letter Ruling on behalf of xxxxxxxxxxxxxxxxx. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the enclosed copy of Section 1200.1120 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to xxxxxxxxx for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither [taxpayer] nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

Director xxxxxxxxxxxx is a xxxxxx national. He was born in xxxxxxxxxxxx, and has remained a xxxxxx resident and domiciliary since that time. He is a director of feature-length motion pictures. He has directed xxxx feature films since xxxx. He has also written over xx feature films since xxxx, and acted as a producer of his xxxx most recent films. All of these films are xxxxxx film productions. Several of his films have been co-produced by xxxxxxxxxxxx ("Studio xxxxx"), one of the leading xxxxxx movie studios.

Director's most successful film, xxxxxxxxxxxx, was made in xxxx and became xxxxxxxx biggest box office hit in history. It was released as a foreign language film in the xxxxxxxxxxxx by xxxxxxxxxxxx xxxxx in xxxx. xxxxxxxxxxxx ("Mr. X"), an xxxxxxxx film writer, producer and director of highly successful xxxxxxxx films, and Studio xxxxx approached xxxxxxxx several years ago, seeking to employ him as the director of an xxxxxxxx, xxxxxxxx language remake of the film, tentatively to be titled, The xxxxxxxx ("The Film"). The xxxxxxxxxxxx ("The Film, Inc."), is a xxxxxxxx-incorporated, wholly-owned subsidiary of Studio xxxxxxxxxxxx subsidiary, xxxxxxxxxxxx ("Studio, Inc."). By contract dated xxxxxxxx x xxx, The Film, Inc. engaged Director, as an employee, to direct the Film in exchange for specified cash compensation. By contract dated xxxxxxxx xx, xxxx, The Film, Inc. engaged Director, also as an employee, to be the Film's associate producer in exchange for specified cash compensation. Director's obligations and duties under each contract are substantially identical. The primary purpose of entering into the associate producer contract was to give Director additional "credit" for the Film.

The Film, Inc.'s executive offices are located at Studio, Inc.'s offices in xxxxxxxxxxxx. The Film, Inc. also maintains a temporary production office in a warehouse on xxxxxxxxxxxxxxxxxxxxxxxxxxxx.

Pursuant to the xxxxxxx x, xxxx contract, Director is obligated in his capacity as the director of the Film to render services during each of the pre-production, production (shooting) and post-production

phases of the creation of the Film. Such services shall be exclusive commencing on xxxxxxxx x, xxxx (the beginning of the contractual pre-production period) through the completion of principal photography (shooting) -- which commenced in late xxxxx and which the Producer anticipates will last a maximum of 21 weeks -- and ending during the post-production period with the delivery of the "second cut" of the film within 15 weeks after completion of shooting. Director's remaining post-production services are to be rendered on a priority, but not exclusive basis. All of Director's post-production services, which are anticipated to take approximately seven months from the last day of principal photography, will be rendered entirely outside of the State of Illinois, predominantly in xxxxxxxxxxxxxx and xxxxxx. Director's duties and obligations under his contract as Associate Producer are largely coextensive with his duties and obligations as Director, except that Director will render all post-production associate producer duties on an as-available basis.

Although each of the contracts specified that Director's pre-production services were to commence on the date the contract was signed (i.e., xxxxxx x xxxx and xxxxxxxxxxx xx xxxx), in fact Director, in accordance with standard industry practice, had an oral understanding with Studio xxx. and with Studio xxxx's chief executive officer, xxxxxxx xxxxxx (the "Studio Chief"), pursuant to which he had been providing pre-production services for a period of almost x years prior to execution of the contract. Director's only compensation for all pre-production services other than script writing is payable to Director, under his two contracts with The Film, Inc. Most of the pre-production activities took place in xxxxx, although some occurred in xxxxxxxx, xxxxxx, and elsewhere, and, beginning in xxxxxxx xxxx, predominantly in xxxxxxx.

The Director's pre-production services included (i) writing and editing the script (which involves the selection of writers and often others to do rewrites as well as editing and negotiating the rewrites);¹ (ii) casting (which involves negotiations between the producers, the studio, agents, managers and lawyers, as well as obtaining visas and a fair amount of tax and business planning for the talent that will be participating in making the picture); (iii) securing and structuring financing; (iv) selecting locations; (v) selecting "below the line" participants (production assistants, assistant directors, second unit directors and assistants, a director of photography, camera operators, gaffers, best boys, key grips, production designers, set decorators, make-up artists, script supervisors, stunt coordinators, costume designers, production accountants, visual effects people, and all the post-production people, described below); (vi) clearing copyright and securing other rights with respect to the picture; and (vii) designing costumes and a multitude of other similar activities.

Most of Director's pre-production services, other than scouting for locations, were rendered outside Illinois. Location scouting took place in xxxxxxx and in Illinois. Director commenced scouting locations in xxxxxxx in xxxxxxx xxx. The production (i.e., the shooting) is expected to take approximately 16 weeks in Illinois and 4-6 weeks in xxxxxxx.

Post-production is a critical component of the making of the Film. Post-production consists of the making of numerous, altogether new elements of the Film, such as sounds, music and visual effects. More specifically, the post-production activity involves inserting high-tech visual imagery throughout the film, editing 250 miles of raw, meaningless film down to 2.5 miles of finished film, voluminous amounts of time mixing tracks for the sound (which involves a musical score, calibrating the volumes of the actors' voices as recorded by the various microphones, editing out extraneous sounds, inserting necessary sounds not picked up by the microphones and dubbing or "looping" actors voices where necessary), adjusting the color of the film and other similar activities. Those activities require huge staffs, all of which will be located outside Illinois, and an immense time commitment on the part of the Director. Such activity is expected to last several months longer than the principal photography, and will occur entirely outside Illinois.

Director has no ownership interest in the Film; rather, he is acting entirely as an employee. The Studio Chief conducted all negotiations with Director on behalf of Studio, Inc. and The Film, Inc. Studio Chief exercises exclusive direction and control over Director in his capacity as the director and associate producer of the Film. The Studio Chief, who is based in xxxxxx, xxxxxx, conducted the negotiations with, and provides supervision of, Director in person, by telephone and in correspondence. All such correspondence and the majority of the telephone calls and personal meetings have occurred outside of Illinois. Director's compensation will be paid entirely outside of Illinois.

Director maintains no residence in Illinois. He is staying in a hotel in xxxxxxxx while temporarily in Illinois in connection with his obligations as director and an associate producer of the Film. Director's presence in Illinois is solely a function of his employment in connection with those obligations. He is here for a temporary and transitory purpose and is not domiciled here.

Director was born in xxxxxx, xxxxxx on xxxx xx, xxxx and he has resided in xxxxxxx since then. Director is married and has one adult child. Both his wife and child live in xxxxxxx, where they are remaining during Director's temporary assignment in the United States and the xxxxxx xxxxxxx. Director's business partners and professional advisors are located predominantly in xxxxxxx, as are his production companies and most of his friends. During the period Director has been in Illinois, he has returned to xxxxxx periodically in connection with other film-related business and to visit his family. His mail, faxes and e-mails are sent to his xxxxxx office where he maintains his business records.

Director pays taxes and files tax returns in xxxxxx, which he will continue to do while on assignment in the United States and the xxxxxxx xxxxxxx in connection with the Film. He receives all of his film-related writing royalties in xxxxxxx.

RULINGS REQUESTED

1. None of Director's compensation paid by The Film, Inc. for directing the Film is compensation paid in Illinois within the meaning of IITA §§ 302(a) or 304(a)(2)(B).
2. None of Director's compensation paid by The Film, Inc. for directing the Film is subject to withholding under IITA § 701(a).

DISCUSSION

Section 302(a) of the IITA provides that compensation paid in Illinois (as determined under IITA § 304(a)(2)(B)) to a nonresident is allocated to Illinois. Similarly, compensation paid in Illinois (as determined under IITA § 304(a)(2)(B)) to an individual is subject to withholding. At issue is whether the compensation by The Film, Inc. to Director for his services as director is "compensation paid in this State" subject to tax and subject to withholding.

IITA § 304(a)(2)(B) provides in pertinent part:

Compensation is paid in this State if:

(i) The individual's service is performed entirely within this State;

(ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State;

(iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

Director's service is not performed entirely within Illinois. The pertinent regulation setting forth the tests for whether compensation is paid in Illinois is 86 Ill. Adm. Code § 100.7010. The regulation applies the same multitiered analysis as the statute. The first question is whether the employee's service is performed entirely within Illinois. IITA § 304(a)(2)(B)(i); Reg. § 100.7010(a)(1)(A). In this case, the answer is no. Director is obligated to, and will, perform his services as an employee in Illinois, in xxx xxxx, and in xxxxxx.

Director's service performed outside Illinois is not incidental to the service he performs in Illinois. If the service is performed both within and without Illinois, then it must be determined whether the service performed outside Illinois is incidental to the service performed in Illinois. IITA § 304(a)(2)(B)(ii); Reg. § 100.7010(a)(1)(B). In determining whether the service performed outside the state is incidental to the service performed in the state, Reg. § 100.7010(c)(2) provides that "the term 'incidental'

means any service which is necessary to or supportive of the primary service performed by the employee or which is temporary or transitory in nature or consists of isolated transactions."

It is clear under this definition that the services Director will perform outside Illinois are not merely incidental to the services performed in Illinois because the Illinois portions of the service provided cannot be said to be the "primary" service within the meaning of the statute. In this case, 75-80% of the location scouting and principal photography will occur in Illinois. All of the very considerable pre-production activity other than location scouting (i.e., casting, securing financing, selecting "below-the-line" participants, etc.) will occur outside Illinois, as will the also very considerable post-production activity which together should significantly exceed the time spent in Illinois. As noted above, the post-production activity involves inserting high-tech visual imagery throughout the film, editing 250 miles of film to 2.5 miles, voluminous amounts of time mixing tracks for the sound (which involves musical score, calibrating the volumes of actors' voices as recorded by the various microphones, editing out extraneous sounds, inserting necessary sounds not picked up by the microphones and dubbing or "looping" actors voices where necessary), adjusting the color of the film and other similar activities. All of that activity will occur outside Illinois and will require a major investment of time by the Director over a period lasting considerably longer than the shooting itself. Shooting the film is thus an important part of making a movie, but cannot be said to be primary or paramount over the pre-production activities and the post-production activities that turn the raw footage into a finished film (and, in this case, not even the entire film will be shot in Illinois).

The second prong of the test in determining whether an activity is incidental is whether it is temporary and isolated in nature. Because the services to be performed outside Illinois are of equal or greater duration to those performed in Illinois, and because the services performed outside Illinois are of equal or greater importance to the completion of the Film than the services performed in Illinois, it cannot be said that the services performed outside Illinois are either temporary or isolated in the context of the production of the Film.

As established by the foregoing, the services the Director will perform outside Illinois are not incidental to the services he will perform in Illinois.

Director's base of operations is in xxxxx. Because the service performed outside Illinois is not incidental to the service performed in Illinois, it must be determined whether Director's base of operations is in Illinois. IITA § 304(a)(2)(B)(iii); Reg. § 100.7010(a)(1)(C). Reg. § 100.7010(d)(2) defines the "base of operations" as --

the place or fixed center from which the individual works. An individual's base of operations may be his business office (which may be maintained in his home), or his contract of employment may specify a place at which the employee is to receive his directions and instructions.

In the absence of more controlling factors, an individual's base of operations may be the place to which he has his business mail, supplies, and equipment sent or the place where he maintains his business records.

In this case, Director's base of operations is in xxxxx. He maintains an elaborate business office in xxxxx where he conducts his numerous activities, employs a staff, maintains expensive high-tech editing equipment, maintains all his business records, and receives his mail, e-mail and faxes. During his stay in Illinois, one of his associates forwards to him in xxxxxxxx any items received in xxxxx that need his immediate attention.

During the pre-production period, Director returned periodically to xxxxx where he spent time in his office attending to business matters. He is expected to continue to do so during the principal shoot, although on a less frequent basis. He will spend considerable time at his xxxxxxxxx office during the post-production period. In contrast, Director does not maintain an office in Illinois. He is staying in a hotel on a temporary basis, and returns to xxxxx as often as his schedule permits.

In these circumstances, it is apparent that Director's base of operations is his xxxxx office. It is clearly not in Illinois. As such, he is not subject to Illinois income tax or Illinois income tax withholding on his salary in connection with the Film.

Director's services are not directed or controlled from Illinois. In the event it is determined, notwithstanding the foregoing, that Director has no base of operations, then his compensation will be deemed to be paid in Illinois if the services are directed or controlled from Illinois. IITA § 304(a)(2)(B)(iii); Reg. § 100.7010(a)(1)(C). The regulation does not prescribe a specific rule for determining the place from which services are directed or controlled. The regulation does, however, provide several examples, one of which is similar to the present situation (except that in the example the direction and control is provided by an Illinois office whereas in this case such direction and control is provided from outside Illinois, a point that has no bearing on the analysis (Reg. § 100.7010(a)(2))). Specifically, Reg. § 100.7010(e)(2)(C) provides the following example:

A, a contractor whose main office is in Illinois, is regularly engaged in road construction work in Illinois and State X. All operations are under direction of a general superintendent whose permanent office is in Illinois. Work in each state is directly supervised by field supervisors working from temporary field offices located in each of the two states. Each field supervisor has the power to hire and fire personnel; however, all requests for manpower must be cleared through the Illinois office. Employees report for work at the field offices. Time cards are sent weekly to the main office in Illinois where the payrolls are prepared. A is hired by a field supervisor in State X; he regularly performs service in both Illinois and State X. In such case, neither the localization nor the base-of-operations test would apply,

but A's compensation would be subject to withholding. Part of A's service is performed in Illinois and his service is regarded as controlled from Illinois because the permanent office from which basic direction and control emanates is the Illinois office.

Director is an employee of The Film, Inc., which is a wholly-owned subsidiary of Studio, Inc., the xxxx subsidiary of Studio xxx. Although some local hiring and firing decisions are made by The Film, Inc. employees at the Illinois production shoot locations, all manpower and other decisions are made by Studio, Inc. in xxx xxxx or xxxxxx xxxx in xxxx. The Film is an expensive picture, and Studio xxxx has invested, and will continue to invest, a great deal of money in it. Therefore, Studio xxx is keenly interested in the details of the production of this film, the Studio Chief has been personally involved in all negotiations with the Director and the principal actors, in most technician hiring decisions, and with the story line and untold other major and minor details of the Film. Indeed, a recent dispute between Studio Chief and Mr. X has led to Mr. X's resignation from the Film. All of Studio Chief's direction and control is issued from xxxx. Additional day-to-day details are directed and controlled from Studio, Inc.'s offices in xxx xxxx. The direction and control that emanates from the Illinois filed office of Studio, Inc. is comparable to, or less than, the direction and control emanating from the field office described in Reg. § 100.7019(e)(2)(C). Under the circumstances, it is apparent that Director does not receive his direction and control from Illinois.

Ruling

Section 302(a) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 *et seq.*) provides that:

All items of compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual who is a nonresident at the time of such payment and all items of deduction directly allocable thereto, shall be allocated to this State.

Section 1501(a)(3) of the IITA defines "compensation" to mean:

wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

You have represented that Director is not a resident of Illinois and that he will be an employee of The Film, Inc. Accordingly, the remuneration Director receives from The Film, Inc. is compensation paid to a nonresident, and is allocated to Illinois only to the extent it is "paid in this State" within the meaning of Section 304(a)(2)(B) of the IITA.

Section 304(a)(2)(B) of the IITA provides that:

Compensation is paid in this State if:

(i) The individual's service is performed entirely within this State;

(ii) The individual's service is performed both within and without this State, but the service performed without this State is incidental to the individual's service performed within this State; or

(iii) Some of the service is performed within this State and either the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within this State, or the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in this State.

You have represented that Director has and will be performing services as an employee of The Film, Inc. both within and without Illinois. Based on this representation, Director's compensation will not be "paid in this State" under Section 304(a)(2)(B)(i).

For purposes of applying the provision of Section 304(a)(2)(B)(ii) of the IITA, 86 Ill. Admin. Code § 100.7010(c)(3) states that, in determining whether services provided by an employee outside Illinois is "incidental" to the services provided within Illinois:

In every case, the ultimate determination to be made is whether the individual's service was intended to be and was in fact principally performed within this State and whether any service which was performed in another state was of a temporary or transitory nature or arose out of special circumstances at infrequent intervals.

You have represented that the services Director has and will be performing in xxxxxxxx and xxxxxx as an employee of the Film, Inc. will be substantial in relation to the services performed in Illinois, will be performed over a longer time period than the period during which services are performed in Illinois, and arise out of the same circumstances -- the production of The Film -- as require Director to perform services in Illinois. Based on these representations, the service Director performs as an employee of The Film, Inc. are not "principally performed" within Illinois, nor are the services performed outside Illinois "temporary or transitory" or arising out of special circumstances relative to the services performed within Illinois. Accordingly, Director's services performed outside Illinois will not be "incidental" to the services he performs within Illinois within the meaning of Section 304(a)(2)(B)(ii) of the IITA, and his compensation from The Film, Inc. will not be "paid in this State" under that subsection.

Under Section 304(a)(2)(B)(iii) of the IITA, Director's compensation will be "paid in this State" if his "base of operations" is in Illinois or if he has no base of operations and the place from which his service is directed or controlled is in Illinois. As you note in your letter, neither the IITA nor the regulation promulgated by the Department contain a definition of "base of operations" that provides a clear answer in this case. You argue that Director's base of operations is his xxxxx office. However, Director's xxxxx office appears to be maintained for his own business purposes unrelated to his activities as an employee of The Film, Inc. We therefore decline to rule that his xxxxx office is his "base of operations" for performing his services as an employee of The Film, Inc.

If it is indeed the case that Director's xxxxx office is not his "base of operations," the key to determining whether or not his compensation is paid in this State is contained in the example in 86 Ill. Admin. Code § 100.7010(e)(2)(C), which states:

A, a contractor whose main office is in Illinois, is regularly engaged in road construction work in Illinois and State X. All operations are under direction of a general superintendent whose permanent office is in Illinois. Work in each state is directly supervised by field supervisors working from temporary field offices located in each of the two states. Each field supervisor has the power to hire and fire personnel; however, all requests for manpower must be cleared through the Illinois office. Employees report for work at the field offices. Time cards are sent weekly to the main office in Illinois where the payrolls are prepared. A is hired by a field supervisor in State X; he regularly performs service in both Illinois and State X. In such case, neither the localization nor the base-of-operations test would apply, but A's compensation would be subject to withholding. Part of A's service is performed in Illinois and his service is regarded as controlled from Illinois because the permanent office from which basic direction and control emanates is the Illinois office.

From the facts stated in your letter, the temporary production office maintained in xxxxxxxx by The Film, Inc. is similar in function to the field offices in the example, which the example states are not a "base of operations." Accordingly, the temporary production office is not Director's base of operations. The facts stated in your letter do not indicate that any other Illinois location could be considered Director's base of operations. Accordingly, assuming that Director does have a base of operations with respect to his performance of services as an employee of The Film, Inc., that base of operations is not located in Illinois.

The example in 86 Ill. Admin. Code § 100.7010(e)(2)(C) also provides guidance for determining the place from which Director's services are directed or controlled. As stated in that example, the temporary production office maintained in xxxxxxxx by The Film, Inc. would not be the place from which Director's services are directed or controlled, even if he were to report there every day for supervision. Both the example and 86 Ill. Admin. Code § 100.7010(e)(1) state that the place from which services are directed or controlled must be a *permanent* establishment. From the facts stated in your request, the only permanent places from which Director's activities are directed or controlled would be the offices of Studio, Inc. in New York, which are shared by The Film, Inc., and the offices of Studio xxx. in xxxx. We decline to rule whether either of these places is the place from which Director's activities are directed or controlled. However, assuming that there is a place from which Director's activities are directed or controlled, based on the representations in your request, that place is not in Illinois. Accordingly, because Director will neither have a base of operations in Illinois nor will his services be directed or controlled from a place in Illinois, his compensation will not be "paid in this State" within the meaning of Section 304(a)(2)(B)(iii) of the IITA.

In conclusion, based on the facts stated in your request, Director's compensation from The Film, Inc. will not be "paid in this State" within the meaning of Section 304(a)(2)(B)(i), (ii), or (iii) of the IITA. Accordingly, his compensation will not be allocated to Illinois under Section 302(a) of the IITA.

Section 701(a) of the IITA provides that:

Every employer maintaining an office or transacting business within this State and required under the provisions of the Internal Revenue Code to withhold a tax on:

(1) compensation paid in this State (as determined under Section 304 (a) (2) (B) to an individual

Because Director's compensation will not be "paid in this State" within the meaning of Section 304(a)(2)(B) of the IITA, The Film, Inc. will not be required to withhold Illinois income tax from that compensation.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Very truly yours,

Paul S. Caselton
Deputy General Counsel -- Income Tax
Illinois Department of Revenue

¹All of Director's services in connection with the Film, except for writing the script, were rendered to The Film, Inc. pursuant to Director's contracts with that entity. For a variety of non-U.S. legal reasons, the Director performed the script writing services under a separate contract with Studio xxxx